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COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter I

Second Amendment to July 14, 2011 Order for Swap Regulation

AGENCY: Commodity Futures Trading Commission.

ACTION: Final order.

SUMMARY: On May 16, 2012, the Commodity Futures Trading Commission (“CFTC” or the “Commission”) published in the Federal Register a Notice of Proposed Amendment (“Notice”) to extend the temporary exemptive relief the Commission granted on July 14, 2011 (“July 14 Order”) from certain provisions of the Commodity Exchange Act (“CEA”) that otherwise would have taken effect on the general effective date of title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”) – July 16, 2011. This final order extends the July 14 Order with certain modifications. Specifically, it removes references to the entities terms, including “swap dealer,” “major swap participant,” and “eligible contract participant” in light of the final joint rulemaking of the CFTC and Securities and Exchange Commission (“SEC”) further defining those terms issued on April 18, 2012; extends the potential latest expiration date of the July 14 Order to December 31, 2012, or, depending on the nature of the relief, such other compliance date as may be determined by the Commission; allows the clearing of agricultural swaps, as described herein; and removes any reference to the exempt commercial market (“ECM”) and exempt board of trade (“EBOT”) grandfather relief previously issued by the Commission.

DATES: This final order is effective July 3, 2012.

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SUPPLEMENTARY INFORMATION:

Background

On July 14, 2011, the Commission exercised its exemptive authority under CEA section 4(c)¹ and its authority under section 712(f) of the Dodd-Frank Act by issuing the July 14 Order that addressed the potential that the final, joint CFTC-SEC rulemakings further defining the terms in sections 712(d)² and 721(c)³ would not be in effect as of July 16, 2011 (i.e., the general effective date set forth in section 754 of the Dodd-Frank Act).⁴ In so doing, the Commission

¹ 7 U.S.C. 6(c).

² Section 712(d)(1) provides: “Notwithstanding any other provision of this title and subsections (b) and (c), the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the Board of Governors [of the Federal Reserve System], shall further define the terms ‘swap’, ‘security-based swap’, ‘swap dealer’, ‘security-based swap dealer’, ‘major swap participant’, ‘major security-based swap participant’, and ‘security-based swap agreement’ in section 1a(47)(A)(v) of the Commodity Exchange Act (7 U.S.C. 1a(47)(A)(v)) and section 3(a)(78) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(78)).”

³ Section 721(c) provides: “To include transactions and entities that have been structured to evade this subtitle (or an amendment made by this subtitle), the Commodity Futures Trading Commission shall adopt a rule to further define the terms ‘swap’, ‘swap dealer’, ‘major swap participant’, and ‘eligible contract participant’.”

⁴ Effective Date for Swap Regulation, 76 FR 42508 (issued and made effective by the Commission on July 14, 2011; published in the Federal Register on July 19, 2011). Section 712(f) of the Dodd-Frank Act states that “in order to prepare for the effective dates of the provisions of this Act,” including the general effective date set forth in section 754, the Commission may “exempt persons, agreements, contracts, or transactions from provisions of this Act,

sought to address concerns that had been raised about the applicability of various regulatory requirements to certain agreements, contracts, and transactions after July 16, 2011, and thereby ensure that current practices would not be unduly disrupted during the transition to the new regulatory regime.⁵ The July 14 Order provided that the relief granted thereunder would expire no later than December 31, 2011.⁶

On December 23, 2011, the Commission published in the Federal Register a final order (the “First Amended July 14 Order”) amending the July 14 Order in two ways.⁷ First, the Commission extended the potential latest expiry date from December 31, 2011 to July 16, 2012 or, depending on the nature of the relief, such other compliance date as may be determined by the Commission, to address the potential that, as of December 31, 2011, the aforementioned joint CFTC-SEC joint rulemakings would not be effective. Second, the Commission included within the relief set forth in the First Amended July 14 Order any agreement, contract or transaction that fully meets the conditions in part 35 as in effect prior to December 31, 2011. This amendment addressed the fact that such transactions, which were not included within the scope of the original July 14 Order because the exemptive rules in part 35 covered them at that time, required

under the terms contained in this Act.” Section 754 specifies that unless otherwise provided in Title VII, provisions requiring a rulemaking become effective “not less than 60 days after publication of the final rule” (but not before July 16, 2011).

⁵ Concurrent with the July 14 Order, the Commission’s Division of Clearing and Intermediary Oversight (which is now two divisions – the Division of Clearing and Risk (“DCR”) and the Division of Swap Dealer and Intermediary Oversight (“DSIO”)) and the Division of Market Oversight (“DMO”) (together “the Divisions”) identified certain provisions of the Dodd-Frank Act and CEA as amended that would take effect on July 16, 2011, but that may not be eligible for the exemptive relief provided by the Commission in its July 14 Order – specifically, the amendments made to the CEA by Dodd-Frank Act sections 724(c), 725(a), and 731. On July 14, 2011, the Divisions issued Staff No-Action Relief addressing the application of these provisions after July 16, 2011. Available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/11-04.pdf>

⁶ 76 FR at 42522 (July 19, 2011).

⁷ Amendment to July 14, 2011 Order for Swap Regulation, 76 FR 80233 (Dec. 23, 2011).

temporary relief because part 35 would not be available as of December 31, 2011.⁸ In so doing, the Commission clarified that new part 35 and the exemptive relief issued in the First Amended July 14 Order, and any interaction of the two, do not operate to expand the pre-Dodd-Frank Act scope of transactions eligible to be transacted on either an ECM or EBOT to include transactions in agricultural commodities.

Discussion of the Notice of Proposed Amendment

On May 16, 2012, the Commission published in the Federal Register a Notice of Proposed Amendment (“Notice”) that would further amend the First Amended July 14 Order in the following four ways. First, in light of the final, joint CFTC-SEC rulemaking further defining the entities terms in sections 712(d), including “swap dealer,” “major swap participant,” and “eligible contract participant,” issued on April 18, 2012,⁹ the Notice proposed to remove references to those terms. Second, the Notice proposed to extend the latest potential expiry date from July 16, 2012 to December 31, 2012 or, depending on the nature of the relief, such other compliance date as may be determined by the Commission. The Notice stated that the extension would ensure that market practices will not be unduly disrupted during the transition to the new regulatory regime.

⁸ The Commission promulgated a rule pursuant to section 723(c)(3) of the Dodd-Frank Act, and CEA sections 4(c) and 4c(b), that, effective December 31, 2011, repealed the existing part 35 relief and replaced it with new § 35.1 of the Commission’s regulations. See Agricultural Swaps, 76 FR 49291 (Aug. 10, 2011). Rule 35.1 generally provides that “agricultural swaps may be transacted subject to all provisions of the CEA, and any Commission rule, regulation or order thereunder, that is otherwise applicable to swaps. [It] also clarifies that by issuing a rule allowing agricultural swaps to transact subject to the laws and rules applicable to all other swaps, the Commission is allowing agricultural swaps to transact on [designated contract markets (“DCMs”), swap execution facilities (“SEFs”)], or otherwise to the same extent that all other swaps are allowed to trade on DCMs, SEFs, or otherwise.” Id. at 49296.

⁹ CFTC-SEC, Further Definition of “Swap Dealer”, “Security-Based Swap Dealer”, “Major Swap Participant”, “Major Security-Based Swap Participant”, and “Eligible Contract Participant” (issued Apr. 18, 2012) (to be codified at 17 CFR pt. 1), 77 FR 30596 (May 23, 2012), available at: <http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister041812b.pdf>.

Third, the Notice proposed to further amend the First Amended July 14 Order to provide that agricultural swaps, whether entered into bilaterally, on a DCM, or a SEF, may be cleared in the same manner that any other swap may be cleared and without the need for the Commission to issue any further exemption under section 4(c) of the CEA. The Notice stated that this amendment is intended to harmonize the First Amended July 14 Order and the final rules amending part 35 of the Commission's regulations, to the extent that the July 14 Order, as amended, maintained the pre-Dodd-Frank Act part 35 prohibition against the clearing of agricultural swaps. The Notice clarified that while the proposed Second Amended July 14 Order would remove the clearing prohibition for agricultural swaps, it would not permit agricultural swaps to be entered into or executed on an ECM or EBOT.

The Commission noted that ECMs and EBOTs both operate some form of trading facility without any self-regulatory responsibilities. The Commission stated its general belief that any form of exchange trading in agricultural swaps should only be permitted in a self-regulated environment. In other words, unlike exempt and excluded commodities, which were generally allowed to be transacted on a trading facility (*i.e.*, platform-traded) in an unregulated environment under the CEA prior to the Dodd-Frank Act¹⁰ and now during the transition to the Dodd-Frank Act regulatory regime, agricultural swaps, which were not allowed to be platform-traded on an ECM or EBOT under the CEA prior to Dodd-Frank Act, may not be platform-traded during the transition to the Dodd-Frank Act regulatory regime. Accordingly, under the Notice and in conjunction with 17 CFR part 35, as effective on and after December 31, 2011, the

¹⁰ One notable exception to this general approach was the heightened regulatory requirements for ECM-listed contracts that served a significant price discovery function under the pre-Dodd-Frank CEA. It is generally recognized, however, that the regulatory regime for ECM significant price discovery function contracts, which included nine core principles, was less rigorous than those applicable to either DCMs (pre- or post-Dodd-Frank) or SEFs. See CEA Section 2(h)(7)(C)(ii)(I)-(IX) (2008) *amended by* the Dodd-Frank Act.

Notice stated that agricultural swaps may only be entered into or executed bilaterally, on a DCM,¹¹ or on a SEF.¹²

In connection with swaps executed on a DCM (whether agricultural swaps or otherwise), the Commission clarified that a DCM may list such swaps for trading under the DCM's rules related to futures contracts without exemptive relief.¹³ As required for futures, a DCM must submit such swaps to the Commission under either § 40.2 (listing products for trading by certification)¹⁴ or § 40.3 (voluntary submission of new products for Commission review and approval)¹⁵ of the Commission's regulations. Swaps that are traded on a DCM are required to be cleared by a DCO.¹⁶ In order for a DCO to be able to clear a swap listed for trading on a DCM, the DCO must be eligible to clear such swap pursuant to § 39.5(a)(1) or (2),¹⁷ and must submit the swap to the Commission pursuant to § 39.5(b).¹⁸

Fourth, the Notice proposed to further amend the First Amended July 14 Order to remove any reference to the ECM/EBOT Grandfather Order, which expires on July 16, 2012.¹⁹ The Notice stated that after July 16, 2012, ECMs and EBOTs, as well as markets that rely on pre-

¹¹ See December 23 Order, 76 FR at 80236, note 11 (Dec. 23, 2011).

¹² See 17 CFR 35.1(b).

¹³ See 76 FR at 80236, note 22 (Dec. 23, 2011).

¹⁴ 17 CFR 40.2.

¹⁵ 17 CFR 40.3.

¹⁶ See 7 U.S.C. 5(d)(11)(A).

¹⁷ 17 CFR 39.5(a).

¹⁸ 17 CFR 39.5(b).

¹⁹ The Commission issued the ECM/EBOT Grandfather Order pursuant to sections 723(c) and 734(c) of the Dodd-Frank Act which authorized the Commission to permit ECMs and EBOTs, respectively, to continue to operate pursuant to CEA sections 2(h)(3) and 5d for no more than one year after the general effective date of the Dodd-Frank Act's amendments to the CEA.

Dodd-Frank CEA section 2(d)(2) (“2(d)(2) Markets”), would only be able to rely on the Second Amended July 14 Order, as proposed therein. The Notice proposed that the relief for ECMs and EBOTs, as well as for 2(d)(2) Markets, granted under the proposed Second Amended July 14 Order shall expire upon the effective date of the DCM or SEF final rules, whichever is later, unless the ECM or EBOT, or 2(d)(2) Markets, files a DCM or SEF application on or before the effective date of the DCM or SEF final rules, in which case the relief shall remain in place during the pendency of the application. The Notice clarified that for these purposes, an application will be considered no longer pending upon the application being approved, provisionally approved,²⁰ withdrawn, or denied.

The Commission sought comment on all aspects of the Notice.

Discussion of the Final Order

The Commission received five comments that related to the Notice.²¹ While generally supportive of the Notice, the comments raised two issues for the Commission’s consideration in this final order: (1) the expiry date applicable to ECMs currently operating pursuant to grandfather relief authorized by section 723(c)(1)-(2) of the Dodd-Frank Act and their market participants and clearing organizations; and (2) the effectiveness of CEA section 2(e) in light of

²⁰ For these purposes, an application is “provisionally approved” on the date that such provisional approval becomes effective such that the ECM, EBOT, or 2(d)(2) Market may then rely on such provisional approval to operate as a DCM or SEF, as applicable.

²¹ Letter from Diana L. Preston, Vice President and Senior Counsel, Center for Securities, Trust & Investments, American Bankers Association, to David Stawick, Secretary, Commodity Futures Trading Commission (May 30, 2012); Letter from Kathleen Cronin, Senior Managing Director, General Counsel and Corporate Secretary, CME Group Inc., to David Stawick, Secretary, Commodity Futures Trading Commission (May 30, 2012); Letter from David M. Perlman, Partner, Bracewell & Giuliani, LLP on behalf of the Coalition of Physical Energy Companies, to David Stawick, Secretary, Commodity Futures Trading Commission (May 30, 2012); Letter from Richard W. Holmes, Jr., Vice President and Counsel, Fifth Third Bank, to David Stawick, Secretary, Commodity Futures Trading Commission (May 30, 2012); Letter from Paul Cusenza, Chief Executive Officer, Nodal Exchange, LLC, to David Stawick, Secretary, Commodity Futures Trading Commission (May 30, 2012). The comment letters are on file with the CFTC and are available via the Commission’s website at: <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1201>.

the further definition of the term “eligible contract participant” (“ECP”). In addition, one commenter specifically supported the Commission’s proposal to permit the clearing of agricultural swaps without further exemption.²² The Coalition of Physical Energy Companies also supported the Proposed Amendment and believed that the Commission should undertake its implementation of the Dodd-Frank Act in a deliberative manner that carefully establishes necessary regulations and avoids inadvertent impacts and over-broad application of the statute.²³

The comments and Commission determinations regarding the two substantive issues raised by commenters are discussed in the sections that follow.

1. Duration of Relief Available to ECM/EBOTs

a. Comments

While supportive of the Notice, CME Group, on behalf of its four DCMs, requested that the Commission clarify one ambiguity it perceived with the Notice – that is, the provision of the Notice stating that the relief proposed shall expire on the earlier of (1) December 31, 2012 or (2) “the effective date of the DCM or SEF final rules, whichever is later,” unless the ECM or EBOT files a DCM or SEF application “on or before the effective date of the DCM or SEF final rules, in which case the relief shall remain in place during the pendency of the application.”²⁴

According to CME Group, the second part of the proposed expiration date is ambiguous because

²² See CME Group Letter at 2. In discussing this aspect of the proposed Second Amended July 14 Order, CME Group noted that for agricultural swaps listed on a DCM, “a DCM will have the flexibility either to self-certify a new agricultural swap contract under Rule 40.2, or to submit the contract for CFTC approval pursuant to Rule 40.3.” *Id.* In adopting, as proposed, the provisions relating to agricultural swaps, the Commission is affirming the discussion of agricultural swaps contained in the Notice, which included the explanation that in addition to a DCM submitting swaps to the Commission under either § 40.2 or § 40.3, “In order for a DCO to be able to clear a swap listed for trading on a DCM, the DCO must be able to clear such swap pursuant to § 39.5(a)(1) or (2), [footnote omitted] and must submit the swap to the Commission pursuant to § 39.5(b).” See 77 FR at 28820-21.

²³ COPE Letter at 1-2.

²⁴ CME Group Letter at 2.

it fails to specify which of the numerous rule proposals concerning SEFs and DCMs must be finalized before relief will terminate.²⁵

CME Group stated that one way to remove this perceived ambiguity would be for the Commission to list each rulemaking that must take effect before the relief will terminate. CME Group also stated that, at a minimum, the ECM and EBOT relief should remain in place until at least the effective date of CFTC implementing rules concerning: (1) all DCM and SEF core principles and (2) block trade size requirements for swaps. Alternatively, CME Group stated that the Commission could address the concern by stating in a final order that the relief remains in effect until a future date the Commission will specify in a future order that will provide at least 60 days notice to market participants and other affected parties.²⁶

Nodal Exchange, which is currently operating as an ECM, sought assurance that the proposed relief would remain in place if an ECM applies to be a DCM after the effective date of the DCM rules, yet still on or before the effective date of the SEF rules.²⁷ To that end, Nodal Exchange offered a change to the operative language of the draft order. Specifically, Nodal Exchange recommended that the phrase at the end of Section (3) of the proposed order be modified to include a second “whichever is later” clause, as emphasized below:

“or (ii) the effective date of the designated contract market ("DCM") or swap execution facility ("SEF") final rules, whichever is later, unless the ECM, EBOT, or 2(d)(2) Market files a DCM or SEF registration application on or before the effective date of the DCM or SEF final rules, whichever is later, in which case the relief shall remain in place during the pendency of the application.”

²⁵ Id.

²⁶ Id.

²⁷ Nodal Exchange Letter at 1-2.

Nodal Exchange explained that this change is necessary because it must file a DCM or SEF registration application on or before the effective date of the DCM or SEF final rules, but to date, the final rules for DCMs that defer implementation of Core Principle 9 and the proposed rules for SEFs would significantly impact Nodal Exchange such that a determination of which registration will be most appropriate is not possible until both the DCM and SEF final rules are published.²⁸ Before submitting the appropriate application, Nodal Exchange stated that it will need to assess (1) how the final regulations implement DCM Core Principle 9 and (2) the finalized rules for SEFs, especially with regard to how the Commission addresses the SEF rules regarding “pre-trade price transparency.”²⁹

b. Commission Determination

The Commission has determined to amend the draft order to include a “whichever is later” clause in provision (b) of section 3 of the Second Amended July 14 Order. That qualifying provision will read as follows: “or (ii) the effective date of the designated contract market (“DCM”) or swap execution facility (“SEF”) final rules, whichever is later, unless the ECM, EBOT, or 2(d)(2) Market files a DCM or SEF registration application on or before the effective date of the DCM or SEF final rules, whichever is later, in which case the relief shall remain in place during the pendency of the application.”³⁰ To be clear, the phrase “DCM or SEF final

²⁸ Id.

²⁹ Id.

³⁰ The Commission currently receives notice filings from ECMs and EBOTs, and thus has a general familiarity with the nature and number of markets operating pursuant to ECM and EBOT exemptive relief. See 17 CFR 36.2(b) and 17 CFR 36.3(a). In order for the Commission to gain a similar familiarity with 2(d)(2) Markets, and to facilitate their eventual transition to registered DCM or registered SEF status, 2(d)(2) Markets operating or intending to operate pursuant to the exemptive relief in this Second Amended Order must provide the Commission with notice of their operations (or intent to so operate) on or before July 16, 2012, or as reasonably soon thereafter as is practicable. Notices should be sent to the Commission’s Division of Market Oversight, 1155 21st St. N.W., Washington, DC

rules” in that provision refers to the following rulemakings: (1) Core Principles and Other Requirements for Designated Contract Markets;³¹ (2) Core Principles and Other Requirements for Swap Execution Facilities;³² and (3) a rulemaking on DCM Core Principle 9.³³ The Commission believes that these changes and clarifications are necessary and in the public interest because finalization of the aforementioned rules is integral to the business decision of whether entities currently operating as ECMs, EBOTs, or 2(d)(2) Markets will transition to DCM or SEF status.

2. Status of CEA Section 2(e) and ECPs

a. Comments

According to Fifth Third Bank, compliance with the Dodd-Frank Act requirements should not become mandatory until the CFTC and SEC provide further guidance as to the

20581 (or electronically, to DMOLetters@cftc.gov), and should include the name and address of the 2(d)(2) Market, and the name and telephone number of a contact person. Such notice will assist the Commission in preparing to review any subsequent application for registration, or provisional registration, as a SEF or DCM submitted by such 2(d)(2) Market. Notwithstanding the provision of such notice, the Commission notes that any subsequent SEF or DCM registration application by a 2(d)(2) Market will still undergo a separate, complete, and independent evaluation by the Commission, just as will every SEF and/or DCM application submitted by an ECM and/or EBOT.

³¹ Core Principles and Other Requirements for Designated Contract Markets, 77 FR 36612 (June 19, 2012) (“Final DCM Core Principles Release”).

³² 76 FR 1214 (January 7, 2011).

³³ In the Final DCM Core Principles Release, the Commission stated that additional time is appropriate before finalizing the proposed rules for DCM Core Principle 9 and that the Commission plans and expects to consider the final rule for DCM Core Principle 9 when it considers the final rule for the SEF Core Principles.

The phrase “DCM or SEF final rules” does not include the Commission’s rulemaking on block trade size requirements for swaps or its rulemaking on the process for a DCM or SEF to make a swap available to trade. See Procedures To Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 77 FR 15460 (March 15, 2012); Process for a Designated Contract Market or Swap Execution Facility to Make a Swap Available to Trade, 76 FR 77728 (December 14, 2011). Those rules will be uniformly applied to both DCM- and SEF- traded swaps and, accordingly, their respective requirements should not have a bearing on whether an ECM, EBOT, or 2(d)(2) Market chooses to apply to become a DCM or a SEF.

meaning of the “revised definition of ECP.”³⁴ Fifth Third Bank stated that section 2(e) of the CEA, as amended by the Dodd-Frank Act, which makes it unlawful for non-ECPs to enter into over-the-counter swaps, together with the rescission of the Commission’s 1989 Policy Statement Concerning Swap Transactions, represent a major change in the rules under which banks have been operating for many years.³⁵ Fifth Third Bank contended that banks (and other swap counterparties) will need to know how to determine whether or not a person is an ECP with a considerable degree of certainty well before the mandatory compliance date for CEA section 2(e) so that they can (1) prepare compliance procedures, questionnaires, and other forms, and (2) train their personnel how to determine whether a person is or is not an ECP. Fifth Third Bank expressed particular concern regarding how to interpret the phrase “amounts invested on a discretionary basis” in the context of CEA section 1a(18)(A)(xi).³⁶ For these reasons, Fifth Third Bank stated that the proposed Second Amended July 14 Order should not assume that the term “ECP” has been adequately defined. In its view, compliance with CEA section 2(e) should not become mandatory until at least 60 days after the CFTC and SEC have provided further guidance regarding the meaning of the term “ECP.”³⁷

Similarly, citing some of the same issues as Fifth Third Bank, the American Bankers Association urged the Commission to amend the proposed order to provide for a continuation of the existing temporary exemption “solely with respect to Section 2(e) until the later of (i) the Proposed Revised Effective Date, or (ii) no less than 60 days after a substantive rule or

³⁴ Fifth Third Bank Letter at 2.

³⁵ Id.

³⁶ Id. at 4-5.

³⁷ Id. at 5.

interpretive guidance on Section 2(e) becomes effective for such purpose (issued either by the Commission or jointly with the SEC).”³⁸

b. Commission Determination

On April 18, 2012, the Commission and the SEC adopted final rules jointly further defining, among other terms, “eligible contract participant.”³⁹ In those rules, the Commissions provided both new categories of ECPs, including a new category based in part on the line of business element of the Commission’s Policy Statement Concerning Swap Transactions,⁴⁰ and interpretations regarding the further definition of the term “ECP.” The Commission and the SEC also delayed compliance with certain aspects of the ECP definition until December 31, 2012.⁴¹

While the Commissions or their staff may, from time to time, issue additional guidance regarding the definition of the term “ECP,” the Commission and the SEC jointly have further defined the term “eligible contract participant,” fulfilling their mandate under Dodd-Frank Act section 712(d)(1) to jointly further define the term “ECP.” In light of the foregoing, the Commission declines requests to modify this final order to delay the effectiveness of section 2(e) beyond the relief already provided.

Nevertheless, because the Commission and the SEC may issue additional guidance concerning, among other issues of concern to commenters, the term “amounts invested on a

³⁸ American Bankers Association Letter at 1-2.

³⁹ See Further Definition of “Swap Dealer,” Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”, 77 FR 30596 (May 23, 2012) (“Final ECP Definition Release”).

⁴⁰ See 17 C.F.R. 1.3(m)(7).

⁴¹ See Final ECP Definition Release at 30596, 30700 (setting forth the compliance dates for Commission regulations 1.3(m)(5), (6) and (8)(iii)).

discretionary basis” in the context of CEA section 1a(18)(A)(xi) after the effective date of section 2(e), the Commission provides the following guidance as to how it intends to exercise its enforcement discretion with respect to certain unintentional violations of section 2(e) by swap counterparties who are making good faith efforts to comply with section 2(e).⁴² More specifically, where a person finds that it has entered into a swap with a counterparty that the Commission and SEC later further define or interpret as not an ECP, absent other material factors, the Commission will not bring an enforcement action for violation of section 2(e) if the person has implemented and followed reasonably designed policies and procedures to verify the ECP status of a swap counterparty⁴³ and, notwithstanding good faith compliance with such policies and procedures,⁴⁴ the person enters into a swap with a non-ECP counterparty.

One example of a fact pattern that the Commission does not believe would exhibit good faith compliance would be treating as an ECP an individual who has total assets, excluding personal property (which the Commission does not expect to treat as “assets invested on a discretionary basis”), that are less than the relevant CEA section 1a(18)(A)(xi) dollar threshold. Conversely, if the individual swap counterparty could be an ECP if the Commission and the SEC further define or interpret some or all of the individual’s assets, other than personal property, to

⁴² Because CEA section 2(e) refers both to ECPs and swaps, both of which, per Dodd-Frank Act section 754, must be further defined before CEA section 2(e) could take effect, now that ECP has been further defined, the further definition of the term “swap” is the sole remaining trigger for the effectiveness of CEA section 2(e).

⁴³ In that regard, see generally Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 FR 9734 (Feb. 17, 2012) (“External Business Conduct Standards Final Release”). See also Final ECP Definition Release at 30646 n. 585 (noting that “market participants must make the determination of ECP status with respect to the parties to transactions in security-based swaps and mixed swaps prior to the offer to sell or the offer to buy or purchase the security-based swap or mixed swap”), 30652 (with respect to determining the ECP status of Forex Pools and referring to the External Business Conduct Standards Final Release), and 30653 n. 656 (with respect to determining the ECP status of Forex Pools)

⁴⁴ For example, an entity could demonstrate good-faith compliance by first seeking, including in connection with the design of its policies and procedures, additional guidance from counsel or from Commission staff, which could address questions on a case-by-case basis with the benefit of specific facts and circumstances.

be “assets invested on a discretionary basis,” absent other material factors, the CFTC would not expect to bring an enforcement action against the counterparty for entering into a swap in contravention of CEA section 2(e). Of course, once the Commission and the SEC further define or interpret a counterparty to be a non-ECP, CEA section 2(e) would prohibit entering into new swaps with such ineligible counterparties. This compliance guidance does not apply to any aspect of the ECP definition that was: (1) not amended by the Dodd-Frank Act; (2) covered by a regulation promulgated in the Final ECP Definition Release; or (3) the subject of an interpretation or other guidance set forth in the Final ECP Definition Release.

Related Matters

A. Paperwork Reduction Act

The Paperwork Reduction Act (“PRA”)⁴⁵ imposes certain requirements on Federal agencies (including the Commission) in connection with conducting or sponsoring any collection of information as defined by the PRA. These amendments to the July 14 Order will not require a new collection of information from any persons or entities that will be subject to the final order.

B. Cost-Benefit Considerations

Section 15(a) of the CEA⁴⁶ requires the Commission to consider the costs and benefits of its action before issuing an order under the CEA. CEA section 15(a) further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5)

⁴⁵ 44 U.S.C. 3507(d).

⁴⁶ 7 U.S.C. 19(a).

other public interest considerations. The Commission considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) factors.

The Commission requested comments on the consideration of costs and benefits of the proposed amendments discussed in the Notice. One commenter, the American Bankers Association, stated that the Commission's consideration of costs and benefits in the July 14 Order did not take into account the costs that would result if CEA section 2(e) were made effective in the absence of further interpretive or regulatory guidance from the Commission.⁴⁷ American Bankers Association states that these costs include the chilling effect on legitimate hedging activity and reduced credit availability, particularly for end users. American Bankers Association further stated that this chilling effect would be compounded by another major concern of its member banks—whether swaps could potentially be subject to challenges for invalidity under state laws. According to the American Bankers Association, a significant benefit of providing temporary relief under section 2(e) in the manner suggested would be the legal certainty this would create under state law for swaps that currently qualify for the line of business provision, and the provision of such temporary relief would be consistent with the Commission's goal of striving to “ensure that current practices will not be unduly disrupted during the transition to the new regulatory regime,” and allow additional time for its member banks to find solutions to their CEA section 2(e) concerns.⁴⁸

As stated above, the rules further defining the term “ECP” were finalized by the Commissions on April 18, 2012. In those rules, the Commissions considered the costs and benefits of the further definitions and guidance regarding the same, including the costs and

⁴⁷ American Bankers Association Letter at 4.

⁴⁸ Id.

benefits of legal certainty. Further, the American Bankers Association comment regarding the costs and benefits of the amendments to CEA section 2(e) made by the Dodd-Frank Act are beyond the scope of this final order, which is limited to amending the temporary exemptive relief first granted by the Commission in the July 14 Order.

Regarding benefits, this final order continues the primary benefit described in the July 14 Order, which is to facilitate an orderly transition to the comprehensive regulatory framework for swaps regulation set out in Title VII of the Dodd-Frank Act. More specifically, this final order temporarily extends the time market participants and the public have to comply with certain provisions of the CEA that reference one or more of the terms to be further defined, and provides guidance with respect to the same in response to various comments. Accordingly, as this final order is an amendment to the July 14 Order, the Commission's consideration of costs and benefits, as set forth in the July 14 Order, may be incorporated here by reference.

Second Amended July 14 Order

The Second Amended July 14 Order shall read as follows:

The Commission, to provide for the orderly implementation of the requirements of Title VII of the Dodd-Frank Act, pursuant to sections 4(c) and 4c(b) of the CEA and section 712(f) of the Dodd-Frank Act, hereby issues this Order consistent with the determinations set forth above, which are incorporated in this final Order, as amended, by reference, and:

- (1) Exempts, subject to the conditions set forth in paragraph (4), all agreements, contracts, and transactions, and any person or entity offering, entering into, or rendering advice or rendering other services with respect to, any such agreement, contract, or transaction, from the provisions of the CEA, as added or amended by the Dodd-Frank Act, that

reference one or more of the terms regarding instruments subject to further definition under sections 712(d) and 721(c) of the Dodd-Frank Act, which provisions are listed in Category 2 of the Appendix to this Order; provided, however, that the foregoing exemption:

- a. Applies only with respect to those requirements or portions of such provisions that specifically relate to such referenced terms; and
- b. With respect to any such provision of the CEA, shall expire upon the earlier of: (i) the effective date of the applicable final rule further defining the relevant term referenced in the provision; or (ii) December 31, 2012.

(2) *Agricultural Commodity Swaps*. Exempts, subject to the conditions set forth in paragraph (4), all agreements, contracts, and transactions in an agricultural commodity, and any person or entity offering, entering into, or rendering advice or rendering other services with respect to, any such agreement, contract, or transaction, from the provisions of the CEA, if the agreement, contract, or transaction complies with part 35 of the Commission's regulations as in effect prior to December 31, 2011, including any agreement, contract, or transaction that complies with such provisions then in effect notwithstanding that:

- a. The agreement, contract, or transaction may be part of a fungible class of agreements that are standardized as to their material economic terms; and/or
- b. The creditworthiness of any party having an actual or potential obligation under the agreement, contract, or transaction would not be a material consideration in entering into or determining the terms of the agreement, contract, or transaction *i.e.*, the agreement, contract, or transaction may be cleared.

This exemption shall expire upon the earlier of (i) December 31, 2012; or (ii) such other compliance date as may be determined by the Commission.

(3) *Exempt and Excluded Commodity Swaps.* Exempts, subject to the conditions set forth in paragraph (4), all agreements, contracts, and transactions, and any person or entity offering, entering into, or rendering advice or rendering other services with respect to, any such agreement, contract, or transaction, from the provisions of the CEA, if the agreement, contract, or transaction complies with part 35 of the Commission's regulations as in effect prior to December 31, 2011, including any agreement, contract, or transaction in an exempt or excluded (but not agricultural) commodity that complies with such provisions then in effect notwithstanding that:

- a. The agreement, contract, or transaction may be executed on a multilateral transaction execution facility;
- b. The agreement, contract, or transaction may be cleared;
- c. Persons offering or entering into the agreement, contract or transaction may not be eligible swap participants, provided that all parties are eligible contract participants as defined in the CEA prior to the date of enactment of the Dodd-Frank Act;
- d. The agreement, contract, or transaction may be part of a fungible class of agreements that are standardized as to their material economic terms; and/or
- e. No more than one of the parties to the agreement, contract, or transaction is entering into the agreement, contract, or transaction in conjunction with its line of business, but is neither an eligible contract participant nor an eligible swap

participant, and the agreement, contract, or transaction was not and is not marketed to the public;

Provided, however, that:

- a. Such agreements, contracts, and transactions in exempt or excluded commodities (and persons offering, entering into, or rendering advice or rendering other services with respect to, any such agreement, contract, or transaction) fall within the scope of any of the CEA sections 2(d), 2(e), 2(g), 2(h), and 5d provisions or the line of business provision as in effect prior to July 16, 2011; and
 - b. This exemption shall expire upon the earlier of: (i) December 31, 2012; or (ii) such other compliance date as may be determined by the Commission; except that, for agreements, contracts, and transactions executed on an exempt commercial market (“ECM”), exempt board of trade (“EBOT”), or pursuant to CEA section 2(d)(2) as in effect prior to July 16, 2011 (“2(d)(2) Market”), this exemption shall expire upon the earlier of (i) December 31, 2012; or (ii) the effective date of the designated contract market (“DCM”) or swap execution facility (“SEF”) final rules, whichever is later, unless the ECM, EBOT, or 2(d)(2) Market files a DCM or SEF registration application on or before the effective date of the DCM or SEF final rules, whichever is later, in which case the relief shall remain in place during the pendency of the application. For these purposes, an application will be considered no longer pending when the application has been approved, provisionally approved, withdrawn, or denied.
- (4) Provided that the foregoing exemptions in paragraphs (1), (2), and (3) above shall not:

- a. Limit in any way the Commission's authority with respect to any person, entity, or transaction pursuant to CEA sections 2(a)(1)(B), 4b, 4o, 6(c), 6(d), 6c, 8(a), 9(a)(2), or 13, or the regulations of the Commission promulgated pursuant to such authorities, including regulations pursuant to CEA section 4c(b) proscribing fraud;
- b. Apply to any provision of the Dodd-Frank Act or the CEA that became effective prior to July 16, 2011;
- c. Affect any effective or compliance date set forth in any rulemaking issued by the Commission to implement provisions of the Dodd-Frank Act;
- d. Limit in any way the Commission's authority under section 712(f) of the Dodd-Frank Act to issue rules, orders, or exemptions prior to the effective date of any provision of the Dodd-Frank Act and the CEA, in order to prepare for the effective date of such provision, provided that such rule, order, or exemption shall not become effective prior to the effective date of the provision; and
- e. Affect the applicability of any provision of the CEA to futures contracts or options on futures contracts, or to cash markets.

In its discretion, the Commission may condition, suspend, terminate, or otherwise modify this Order, as appropriate, on its own motion. This final Order, as amended, shall be effective immediately.

Issued in Washington, DC, on July 3, 2012 by the Commission.

Sauntia S. Warfield

Assistant Secretary of the Commission

NOTE: The following appendix will not be published in the Code of Federal Regulations

Appendix 1- Statement of Chairman Gary Gensler

I support the exemptive order regarding the effective dates of certain Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) provisions.

Today's exemptive order makes five changes to the exemptive order issued on December 19, 2011.

First, the proposed exemptive order extends the sunset date from July 16, 2012, to December 31, 2012.

Second, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) have now completed the rule further defining the term "swap dealer" and "securities-based swap dealer." Thus, the exemptive order no longer provides relief as it once did until those terms were further defined.

The Commissions are also mandated by the Dodd-Frank Act to further define the term "swap" and "securities-based swap." The staffs are making great progress, and I anticipate the Commissions will take up this final definitions rule in the near term. Until that rule is finalized,

the exemptive order appropriately provides relief from the effective dates of certain Dodd-Frank provisions.

Third, in advance of the completion of the definitions rule, market participants requested clarity regarding transacting in agricultural swaps. The exemptive order allows agricultural swaps cleared through a derivatives clearing organization or traded on a designated contract market to be transacted and cleared as any other swap. This is consistent with the agricultural swaps rule the Commission already finalized, which allows farmers, ranchers, packers, processors and other end-users to manage their risk.

Fourth, unregistered trading facilities that offer swaps for trading were required under Dodd-Frank to register as swap execution facilities (SEFs) or designated contract markets (DCM) by July of this year. These facilities include exempt boards of trade, exempt commercial markets and markets excluded from regulation under section 2(d)(2). Given the Commission has yet to finalize rules on SEFs, this order gives these platforms additional time for such a transition.

Fifth, the Commission is providing guidance regarding enforcement of rules that require that certain off-exchange swap transactions only be entered into by eligible contract participants (ECPs). The guidance provides that if a person takes reasonable steps to verify that its counterparty is an ECP, but the counterparty turns out not to be an ECP based on subsequent Commission guidance, absent other material factors, the CFTC will not bring an enforcement action against the person.

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